

Rùnaire a' Chaibineit airson Ionmhas agus na h-
Eaconamaidh
Cabinet Secretary for Finance and Economy
Ceit Fhoirbheis BPA
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Rt Hon Rishi Sunak MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
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18 March 2022

Dear Rishi,

I am writing ahead of your spring forecast statement on 23 March to outline actions required from the UK Government in a number of areas, to address the impact of the substantial rise in the cost of living, the practical implications of the unfolding tragedy in Ukraine and the need for fuller proposals to replace EU funding. This builds on the dialogue that our two governments have had on some of these issues.

There are acute challenges currently facing households, public services and the economy as a whole, ranging from the continuing pandemic to the cost of living crisis to the implications of Russia's illegal invasion of Ukraine. Therefore it is not a time for government to be ducking the considerable challenges we face, and I trust you will take the opportunity of your fiscal statement to take the significant action needed to support citizens, considering that most of the relevant levers are reserved to the UK Government.

Reflecting the extent of the issues facing us as governments, you may be aware that the First Minister has supported calls for the UK Government to implement a windfall tax, to ensure a fair contribution from companies benefiting from circumstances which at the same time see ordinary people suffer; and that the Cabinet Secretary for Net Zero, Energy and Transport, Michael Matheson, wrote to the Secretary of State for Business, Energy and Industrial Strategy on 18 March regarding further energy policy interventions. This includes accelerating the decarbonisation of electricity (in part to support the decarbonisation of heat and transport), reforming the network charging system, creating new business models for green hydrogen, rebalancing policy costs on bills to protect consumers and accelerating the delivery of the Scottish Cluster for carbon capture and storage. His letter is annexed for reference.

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Support for households and businesses

While the economy is recovering from the impact of the pandemic, it now faces a new economic shock as a result of Russia's illegal invasion of Ukraine. This will increase prices for oil, gas and other commodities and will drive inflation even higher – with the Bank of England forecasting inflation of 8 per cent in the second quarter of this year and noting that it could rise further by several percentage points later in the year, depending on the level of the next energy price cap.

Large rises in energy bills, increased costs for everyday essentials, rising interest rates and the UK Government's new National Insurance hike are causing huge concern and worry, and people are struggling, particularly low-income households. Higher input costs will also mean that businesses will see their margins squeezed. Therefore I urge you to prioritise support for households and businesses to deal with this crisis. The Scottish Government is using its limited powers and resources to do everything we can but this must be matched. The UK Government must use its reserved levers to make substantial and significant interventions.

In particular, as suggested by the Resolution Foundation and the Institute for Fiscal Studies, and in order to better target support at those on lower incomes, benefits such as child benefits and Universal Credit should be increased at a higher rate that is closer to the current rate of inflation. This need not set precedent – it is clear that it is a specific need at this time of a cost of living crisis, and accordingly the Scottish Government has acted to uprate benefits as set out below. Further to this, and in light of your continued commitment to increase National Insurance Contributions (NICs), businesses should be supported by a short term NICs relief, which would also avoid the risk of their passing on the additional cost of increasing NICs to consumers.

Further, as repayments under the Coronavirus Business Interruption Loan Scheme are due to start at the end of this month, alongside the end of the moratorium on rents and wind-up petitions, there must be measures in place to enable a smoother transition for businesses.

Some sectors of the economy require immediate support because of the direct impact they are experiencing from the Russia/Ukraine conflict, including agriculture, manufacturing, haulage, and food and drink. Action is needed now to ensure that jobs are not lost in viable businesses. Businesses in those sectors require funding from Government. Funding would help sectors to cover losses inflicted by supply chain and market access constraints, as well as volatile and rising energy costs in energy intensive industries. The Scottish Government and its enterprise agencies should shape the direction of any such funding as we know the business needs of the affected sectors in Scotland, and can respond to regionally specific sectoral challenges.

Michael Matheson's letter referred to earlier set out a number of ways that the UK can support households with the rising cost of living, as well as accelerate the transition to net zero and reduce reliance on oil and gas. We have already called for a removal or reduction in VAT from household energy bills in the short term, in addition calling on you now to introduce a windfall tax to fund targeted support for those who need it most.

I also urge you to commit to rebalancing the policy costs element of energy bills to reduce the premium paid by households reliant on electric heating and to help to unlock the

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deployment of low and zero emissions heating. Furthermore, as VAT policy control is reserved to the UK Government, I would urge that all policy levers are considered to help people through this crisis, including the reduction or removal of VAT on household energy bills.

It is also crucial that targeted direct support to consumers be provided as soon as possible and without the need for repayment. Furthermore, we call for an immediate removal of VAT on energy efficiency and zero emissions heat equipment and products. This would significantly increase take-up of these products, thereby supporting reduced household demand for energy as well as supply chain growth in this key sector.

In relation to employment, as noted in our response to the consultation run by BEIS on the forthcoming Employment Bill, we set out why the Scottish Government should have the necessary powers to work with employers to implement flexible working policies. This would allow us to remove a significant barrier to people entering employment or moving between jobs, particularly for those with caring responsibilities. While 60 per cent of people work flexibly, fewer than 30 per cent of roles are advertised as flexible, which deters many people from applying for posts, and this is something we are keen to address. Supporting people into flexible work can increase working hours for people and would address poverty and inequality. We also need a fair and appropriate response on public sector pay. While the Scottish Government has for years focused on protecting those on the lowest incomes, the UK Government's approach to pay flows limits our consequential funding. And while I appreciate the processes you have in respect of pay review bodies, I would urge you to give firmer assurances about sensible pay uplifts for our public sector workers.

Responsive and responsible welfare support

To support low-income households and carers in light of the increasing cost of living pressures, the Scottish Government has taken the decision to uprate eight Scottish benefits by 6 per cent from 1 April as well as increase our Scottish Child Payment by 100 per cent from £10 per week per eligible child to £20. We have chosen to take action and use our powers to help those who need us most in these difficult times, and I am calling on you to follow our lead and uprate social security benefits by 6 per cent.

Under the current devolution settlement most of the social security levers sit with the UK Government, and the support offered to date is simply inadequate. We have written to your Government many times to raise concerns about the effect that withdrawing the Universal Credit uplift will have on poverty levels, particularly child poverty, and the overall financial health and well-being of people. I again urge the UK Government to reverse this decision, reinstate the £20-per-week uplift to Universal Credit and strengthen the support offered by Universal Credit instead of weakening it.

I would also ask you to take direct action to support low-income households through the Cold Weather Payment as a means of providing immediate support, by making an additional payment now and then again in winter 2022-23 when we know energy bills will have risen again. This would help people without needing a link to particular cold weather. People are facing higher bills right now, yet very few Cold Weather Payments have been made this winter – only six payments. This is closer to the policy intention of our replacement for Cold

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Weather Payments from winter 2022-23, with an annual payment of £50 guaranteeing support for heating costs to approximately 400,000 people regardless of the weather.

Replacement EU funding

I understand that the plans and the quantum for the Shared Prosperity Fund may be announced as part of your statement. I would reiterate the factual position that Scotland requires at least £183 million per annum to replace the EU structural funds including LEADER and the European Territorial Cooperation Programmes, and that convention, the devolution settlement and plain common sense all support this money being transferred in full for the Scottish Government to control. In this context, I also note the outcomes of our Strategic Transport Projects Review 2 and the UK Government's Union Connectivity Review.

The rural economy needs assurances of the future support available to it. Replacement EU funding will form a key part of our economic recovery and, following EU exit, we no longer have the certainty of a full seven years of funding. We welcome the continuation of the Bew Review funding settlement until 2024-25, however we still await meaningful discussions to agree the principles of future intra-UK allocations, in line with the commitment from UK Government and Mr Eustice. We need these discussions to proceed as soon as possible. As it stands, the proposed rural funding provides insufficient budget to replace EU funding levels lost and Scotland is set to lose out on approximately £93 million between 2021-22 and 2024-25.

Following the UK's departure from the EU, we also provided clear evidence to the UK Government of a multi-year £62 million annual allocation for marine funding that we could have accessed as EU members. Instead, the UK Government has allocated £14 million annually to Scotland, which fails to recognise the value and importance of Scotland's seas. Such a reduced funding pot means reduced opportunity to realise benefits for coastal communities, marine businesses and the marine environment in Scotland, and this must be rectified as soon as possible.

I trust this letter is helpful, and look forward to dialogue between our governments across these urgent issues, including with the Chief Secretary to the Treasury at the upcoming Finance Inter-ministerial Standing Committee.

Yours sincerely,



KATE FORBES

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LETTER FROM THE CABINET SECRETARY FOR NET ZERO, ENERGY AND TRANSPORT TO THE SECRETARY OF STATE FOR BUSINESS, ENERGY AND INDUSTRIAL STRATEGY, 18 MARCH

Dear Kwasi,

I am pleased to give my support to the announcement last week that the UK is looking to end the importation of Russian oil and gas by the end of this year. However, at this juncture, I want to make it clear that I find it completely unacceptable to read about the future direction of the UK Government, in particular the forthcoming publication of a National Energy Independence Strategy, in the press.

The Scottish Government has not been consulted on this National Energy Independence Strategy at either ministerial or official level, which is hard to believe given the vital role that Scotland already plays in exporting electricity and gas to the rest of the UK and beyond. As you are no doubt aware Scotland exported 20.4 TerraWatt hours of electricity in 2020, enough to power every household in Scotland for 26 months. In addition Scotland exported 17 Mtoe of natural gas to the rest of the UK in 2019, which accounted for 42% of the rest of the UK's total gas consumption.

Furthermore, I understand that the Prime Minister met with key energy stakeholders to discuss increasing investment in the North Sea Oil and Gas Industry, again this appears to have happened without input from The Scottish Government.

While the oil and gas sector has, and continues to remain, a key part of the Scottish economy, increasing domestic production is not the way to end dependence on fossil fuel from Russia. Instead we should be looking to immediately accelerate the transition to renewables and reduce our dependence on oil and gas products. This type of global shock to the energy system requires collaboration and action across all areas of energy policy.

As you will know, at EU level the key institutions are working to reduce dependency on Russian fossil fuels. The European Commission's 'RePowerEU' plan, published on 8 March 2022, assesses that it could reduce dependence by nearly two-thirds within a year, and entirely before the end of the decade. Individual EU states are also taking action, with Germany last week announcing that it had earmarked 200 billion euros to fund industrial transformation between now and 2026.

The UK cannot be left behind in this transition and there is a huge opportunity to both decrease our dependence on oil and gas products from Russia as well as further accelerate the transition to net zero to mitigate the worst impacts of climate change. With that in mind, I have the following key asks for the UK Government:

- **Accelerate the decarbonisation of electricity.** There is an immediate need to increase investment to meet our net zero ambitions. In particular; anticipatory investment required to enable the swift connection and transportation of renewable electricity and, to enable the accelerated decarbonisation of heat and transport, should be approved without delay. In particular, we have heard from ScotWind developers who have expressed concern around National Grid's plans to only account

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for 10.7GW of ScotWind in the forthcoming Holistic Network Design publication. While we are aware that the transformational nature of ScotWind requires careful consideration, BEIS, Ofgem and National Grid ESO must consider how to accelerate electricity network investment in order to enable ScotWind projects to connect to the electricity system without delay.

- While the increased frequency of CfD allocation rounds is welcomed, the ring-fenced budget allocated for emerging technologies should be increased to ensure the potential pipeline of floating offshore wind and marine projects can achieve commercialisation. Importantly we should not be looking backwards to traditional nuclear technologies which, we know, in addition to their waste and environmental concerns, are poor value for consumers compared to renewables. Further, the long lead in times for the construction of nuclear fission reactors means that even if new projects were approved today there would be no immediate benefit to energy security. Finally, we need to rapidly increase the development and construction of planned interconnectors so that we can support our European partners as they look to decrease their reliance on Russian fossil fuel products.
- **Reform the network charging system.** Scotland has some of the most extensive renewable generation capabilities in Europe but investments in these areas are being held back by unfair network charges, which are focussed on the location of generation. In a net zero world, it is counterproductive in the extreme to care more about where generation *is situated* than what *type of generation it is*. Instead, taking forward reform to reward those developers who are investing in renewable generation (and supporting technology like storage) will allow us to meet the net zero targets by accessing the best locations for these sites; not make them more expensive.
- **Accelerate the delivery of the Scottish Cluster:** Carbon Capture and Storage (CCS) is vital component for delivery of our statutory emission reductions targets. The UK Government's cluster sequencing decision has not provided Scotland with clarity on the potential for UK government support, despite its 'reserve' status demonstrating its suitability for delivery. The UK Government should give certainty to the Scottish Cluster and find a solution to bring it online at an accelerated pace. Now is not the time to artificially hold back on decarbonisation when industry is primed to invest. We wish to work collaboratively on solutions to funding and delivery of CCS in Scotland and for our emissions targets, energy security, and unique opportunity to raise revenue for the exchequer through storage of international CO2 to be recognised as key in the acceleration of our decarbonisation efforts. We continue to advocate for the Cluster and have offered the UK Government £80 million from our Emerging Energy Technologies Fund to accelerate deployment.
- **Accelerate business models for green hydrogen:** The UK Government should also accelerate the design and application of the UK hydrogen business model and other market mechanisms to support hydrogen production and use. This is an immediate action that is necessary to provide market certainty and investor confidence to enable the development of hydrogen production required in Scotland to meet domestic demand from transport, industry and other sectors in the mid-2020s and underpin the future export market. The acceleration of the UK hydrogen business model to support hydrogen production will also help to address energy storage and supply issues, with

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hydrogen production unlocking the use of onshore constrained renewables and supporting the management of constrained electricity, potentially reducing the scale of constraints payments and introducing new options for energy storage and system balancing.

- **Accelerate energy efficiency and the decarbonisation of heat:** Reducing our heat demand and decarbonising heat is one of the most challenging elements of achieving net zero. One area where rapid action should be taken is to increase energy efficiency for both domestic and non-domestic buildings. This will have multiple benefits, it will reduce heat demand and will improve the health and wellbeing of those living in the most inefficient properties. Scotland's long standing support schemes for energy efficiency improvements have already helped over 150,000 households in, or at risk of, fuel poverty. In addition, the Scottish Government has committed to investing at least £1.8 billion over the lifetime of this parliament in energy efficiency and heat decarbonisation measures. The UK Government should remove the financial barriers preventing the creation of commercially viable large scale heat decarbonisation and provide better incentives for investment in enabling infrastructure. It should also develop innovative financing mechanisms and appropriate levels of consumer protection which will give confidence to property owners looking to improve the carbon footprint of their homes.
- **The UK Government must commit to rebalancing the policy costs on energy bills to reduce the premium paid by households reliant on electric heating** and help to unlock the deployment of low and zero emissions heating. Furthermore, as VAT policy control is reserved to the UK Government, I would urge that all policy levers are considered to help people through this crisis, including the reduction or removal of VAT on energy bills. We also call for an immediate removal of VAT on energy efficiency and zero emissions heat equipment and products. This would significantly increase take-up of these products thereby supporting reduced household demand for energy as well as supply chain growth in this key sector.
- **Accelerate the Decarbonisation of Transport:** The Scottish Government has been clear that technology alone will not achieve the transformational change required for transport to play its part in the transition to net-zero. Fundamental behaviour change and mode-shift will be required, mirroring assertions, from the UK Committee on Climate Change, that demand for travel also has to be reduced. In recognition of this, in January of this year the Scottish Government published a draft route map for our world leading ambition to reduce car kms by 20% by 2030. The UK Government must set out a timeline for productive engagement on incentives and tax structures that are fair, progressive and support net zero choices, alongside investment in net zero technologies, including reform of fuel duty and vehicle excise duty. It is also important that the National Independent Energy Strategy also considers measures to strengthen the support for hydrogen as a transport fuel, recognising the role that hydrogen, particularly green hydrogen, can play in the transport sector.

Taking these steps immediately would put the UK not only onto an accelerated pathway to net zero but help reduce our reliance, and that of our closest allies and partners, on oil and gas products from a regime currently engaged in unprovoked war against Ukraine.

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There are opportunities for Scotland and the rest of the UK to become a world leader in the creation of a net zero economy, if only there is the will to grasp those opportunities rather than fall back on fossil fuels.

I welcome the opportunity to discuss these points with you at your earliest convenience and I look forward to hearing from you on how you plan to include my officials in the development of key pieces of work such as this moving forward.

Yours sincerely,

MICHAEL MATHESON

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